

GLOBAL CREDIT PROGRAM FOR MICROENTERPRISES IN NORTHEASTERN BRAZIL

(BR-0301)

EXECUTIVE SUMMARY

Borrower:	Banco do Nordeste do Brasil (BN)	
Guarantor:	Federative Republic of Brazil	
Executing agency:	Banco do Nordeste do Brasil (BN)	
Amount and source:	IDB (OC):	US\$30 million
	Local:	<u>US\$30 million</u>
	Total:	US\$60 million
Financial terms and conditions:	Amortization period:	20 years
	Commitment period:	3 years
	Disbursement period:	4 years
	Interest rate:	variable
	Inspection and supervision:	1.00%
	Credit fee:	0.75%
	Currency (OC):	Single Currency Facility
Objectives:	<p>The main objective of the program is to help strengthen microenterprises in northeastern Brazil by financing a massive expansion in the supply of formal microcredit in the region, a process undertaken by the BN in 1997 through its <i>CrediAmigo</i> program, consistent with the Government of Brazil's strategy. Specifically, the aim is to attract 120,000 new customers over the life of the operation, thereby tripling <i>CrediAmigo's</i> coverage compared with year-end 2000.</p>	
Description:	<p>The proposed operation would consist of two components: (i) loans for microenterprise; and (ii) technical assistance for the institutional strengthening of <i>CrediAmigo</i>. The total cost of the operation has been estimated at US\$60 million. The cost of the lending component would be US\$56 million (US\$27 million provided by the BN and US\$29 million provided by the IDB). The cost of the technical assistance component would be US\$4 million (US\$1 million from the IDB financing and the rest from the BN). In addition to this operation, in May 2000, the World Bank approved a loan of US\$50 million to the BN with similar objectives, of which US\$8 million had been</p>	

disbursed as of 31 May 2001. Of this amount, US\$47 million will be used to increase lending resources under the *CrediAmigo* program and US\$3 million will go towards technical cooperation for *CrediAmigo*.

The institutional strengthening activities to be financed through the technical assistance component of this operation will be directed toward eight areas to help accomplish the proposed objectives of expanding *CrediAmigo*: (i) marketing; (ii) risk management; (iii) loan officer productivity; (iv) wider geographic coverage; (v) the identification of new products; (vi) environmental risk management; (vii) studies and promotion of mechanisms to channel funds through private institutions; and (viii) loan administration.

The resources under the loan component would be used to partially finance expansion of the *CrediAmigo* program portfolio over the next four years. The resources provided under the present operation, combined with those from the World Bank loan, will cover approximately 70% of the funding requirements anticipated by *CrediAmigo* for that period. The balance will be provided from the BN's own resources. The resources will be used to provide financial assistance in the form of loans for working capital and fixed capital to urban microenterprises through *CrediAmigo* branch offices, using technology for solidarity groups composed of three to seven microentrepreneurs, with individual loans to such microentrepreneurs for up to a maximum equivalent to US\$1,600 currently.

**The Bank's
country and
sector strategy:**

The Bank's country strategy is based on five objectives: (a) economic growth with equity; (b) public sector reform; (c) enhanced competitiveness; (d) alleviation of social problems; and (e) revitalization of regional integration. This operation is consistent with the objectives described in (a) above and forms part of the activities designed to alleviate poverty through the promotion of private productive activities.

To determine the most viable and effective means of achieving the program's objectives, evaluations were conducted of the various potentially-available alternatives: (i) financing one or more NGOs in the region directly; (ii) creating a private second-tier mechanism, which would channel resources through commercial banks; (iii) financing a private bank to develop a first-tier program; and (iv) backing an informal microenterprise support program within a public bank, which would then evolve into a subsidiary network as an economically viable independent entity. It became clear, from the evaluations, that massive coverage for informal microenterprises by private banks was not a possibility that could attract a significant number of entities in the short term. Moreover, it is unlikely that the NGOs located in the Northeast will reach the number and dimensions

required to accomplish the main objective of the program—the massive expansion of credit—in the near future. The use of the BN, the State-owned development bank with the broadest physical coverage in the region as executing agency for the program, turned out to be the only truly viable alternative, taking into account its commitment to providing services to microenterprise.

Environmental and social review:

This operation has been reviewed by CESI, and all recommendations made by that Committee have been incorporated into the design of the operation. Annual evaluations on environmental impact and compliance with manuals and regulations on environmental standards are provided for.

Benefits:

The benefits of the program include: (i) a positive social impact in terms of improved income levels for disadvantaged population segments in the country's poorest region; (ii) greater access to microcredit for an increasing number of small-scale productive units currently without access to financing; and (iii) support for the long-term institutional consolidation of the *CrediAmigo* program.

Risks:

Exogenous factors could disrupt the macroeconomic framework and undermine price stability, dampening demand for credit. The international economic slowdown and the energy crisis the country is experiencing have had a negative impact on economic growth targets for 2001. Brazilian authorities have adopted the necessary corrective measures to overcome this situation in the short term. There are also certain risks that are often associated with the use of a public bank as a first-tier intermediary for channeling credit resources to the private sector, such as: (i) inefficient mechanisms for resource allocation and recovery, resulting in losses that make repeated recapitalizations on the part of the federal treasury necessary; (ii) subsidized operating conditions or privileged regulatory and statutory frameworks that undermine the initiatives for expansion of private-sector participation in the provision of financial services; and (iii) potential vulnerability to political interference in the entity's operational decisions. To the above risks, in the specific case of *CrediAmigo* we would add the risk of deterioration of its incipient financial sustainability because of the rapid rate of expansion provided for in the program. Both types of risk were considered during the analysis and design of the operation and safeguards were introduced in the form of operational systems, policies, and procedures that are expected to provide adequate coverage. In order to verify the mitigating impact of the measures adopted, special oversight and monitoring conditions have been established, as described further on.

Lastly, it should be noted that the BN has agreed with the Bank (as well as with the World Bank) that the *CrediAmigo* program must

evolve into a legally and operationally independent entity. While the separation of accounting systems has been achieved in a first step, important legal and regulatory obstacles to *CrediAmigo*'s complete independence were discovered during the analysis of this operation. Nevertheless, there are plans to move further in that direction as soon as possible. The resources under the technical assistance component of this operation will in part be applied to activities with that objective.

**Special
contractual
clauses:**

The BN has agreed with the Bank on the following conditions precedent to the first disbursement: (a) evidence that the program credit regulations and *CrediAmigo* operating manual have entered into effect and conform to the version previously agreed upon with the Bank; (b) evidence satisfactory to the Bank that a separate accounting system will be maintained for *CrediAmigo* and for the program, to enable financial statements to be prepared that are independent of the BN's financial statements; (c) presentation to the Bank's satisfaction of the model documents to be used for the formal issuance of loans to subborrowers; and (d) fulfillment of the special conditions precedent to disbursement of the resources of the financing described in Table II-3 of this document, which are related to monitoring the financial performance of *CrediAmigo* and Banco do Nordeste and the execution of the latter, with its own resources that are additional to this operation, of a pilot credit program in the amount of US\$2.5 million with at least five credit unions operating in the Northeast.

In addition, the borrower and the Bank will conduct periodic reviews (based on disbursement levels and timing) of those aspects of program execution that have to do with fulfillment of targets and the results achieved, according to a schedule included in Table II-3 of this document. The Bank will only resume disbursements of the financing after ascertaining that the targets established for each level of execution have been achieved. In addition, if after the reviews the Bank should consider that the program did not substantially achieve the expected results, prior to resuming disbursements, the Bank and the borrower will agree to measures that the latter must take to resolve the problems identified.

The semiannual execution reports provided for in the General Conditions of the contract will be presented to the Bank's satisfaction, and will include the following information:

- (i) the program's financial and institutional status;
- (ii) fulfillment of program monitoring and evaluation tasks;
- (iii) changing pattern of the *CrediAmigo* business plan;

- (iv) environmental impact and degree of compliance with manuals and regulations on environmental standards;
- (v) fulfillment of the financial targets and indicators relating to the *CrediAmigo* (see Table II-4).

Poverty-targeting and social sector classification:

Given the target population of this program (microentrepreneurs), it is automatically qualified as a poverty-targeted operation.

Exceptions to Bank policy:

None.

Procurement:

Standard Bank procedures will be used, as applicable, for the procurement of goods and services.